



In the first part of our Country Commentary for China, *World Leather* June-July, we analysed the impact on the country's wider economy of its ongoing trade dispute with the US. Part two examines more closely the impact of the current economic situation on industries that are extensive users of leather.

Country Commentary

Complexities of the Chinese market

China's economy grew by 6.2% in the second quarter of this year, the lowest quarterly growth figure for 27 years. Commentators were quick to point to the effect on China's economy of the country's ongoing trade dispute with the US, not least because growth in the first quarter of the year (before more punitive tariff rates came into force in May) was higher at 6.4%. But the government in Beijing said on reporting the latest figures that factory output and retail sales data for the month of June offered signs of encouragement. With trade tensions with the US continuing, the Chinese government has predicted overall growth of between 6% and 6.5% in the second half of 2019.

Cars cause concern

Looking at specific industries that, traditionally, have consumed high volumes of leather, automotive is one that is causing tanners around the world some concern. If automotive was the leather industry's principal saving grace for most of this decade, it was the Chinese car market specifically that gave automotive original equipment manufacturers (OEMs) the greatest hope of growth.

Car production in China has declined again this year after worrying falls in 2018, although measures are already in place to

encourage consumers to buy again. For example, dealers across the country are now offering discounts to customers in an attempt to move built-up inventory. The sales figures do not lie, though. In the first six months this year, the Volkswagen group sold just over 1.9 million passenger vehicles in China, under all its brands (Volkswagen, Audi, Skoda, Seat, Porsche, Bentley, Lamborghini and Bugatti). This still makes China far and away the group's biggest market because sales in second-placed Germany were just over 690,000 vehicles, followed by the US with a little under 320,000. However, 1.9 million represents a decline of 3.9% compared to the first six months of 2018.

The next-biggest global group for sales in China is General Motors, which, across all its brands (Buick, Chevrolet, Cadillac and its local joint-venture brands Wuling and Baojun) delivered just over 1.5 million new vehicles in the first six months of 2019. This represents a decline of 15% compared to the first half of last year. Japanese group Nissan reported first-half sales of 722,176 vehicles in China, down by 2.6%.

For Ford, the figures for the first half of the year show sales of 241,000 vehicles in China, representing a decline compared to the same months in 2018 of 34.6%. In comments to the BBC at the start

Toyota models C-HR and IZOA at the Auto Shanghai 2019 event.
CREDIT: TOYOTA





of August, Ford company president for automotive, Joe Hinrichs, was reluctant to blame the trade tensions entirely for this downturn. He said the group is a net exporter of vehicles to China and that tariffs increasing to 40% in the first phase of the tariff dispute in 2018 hurt. "They've come back down to 15%," he said. "There are more tariffs on parts and autos coming into the US, so we are still seeing some impact from that. Our sales in China are down significantly, but they are down more because of our actions than because of any trade agreement."

Of the five biggest global groups, Toyota is the only one that has bucked this trend. The figures available at the time of writing are for the first five months of 2019, in which Toyota sold just under 630,000 vehicles in China, an increase of 10.9%. The group said that those months yielded particularly strong sales of Lexus vehicles and of Toyota models such as the Avalon, which went on sale in China in March, and the Camry. It added that the figure for the month of May on its own marked a record high for sales of Toyota cars in China.

Nevertheless, in July, the *Wall Street Journal* said that China had become "tricky terrain" for global automotive brands, and that China had rapidly gone from being "the industry's most bankable source of growth" to a much more challenging prospect because demand for new cars among consumers there has levelled off.

Leathergoods and China's digital challenge

As automotive's star has waned, luxury leathergoods has increasingly become the brightest sight in the leather firmament and research and consultancy firm Gartner is in no doubt about the importance of China. In a June report called *Luxury China 2019*, Gartner said that despite a downturn in the overall Chinese economy in recent time, the luxury market there grew by 20% in 2018. Many brands have been successful in adapting to what a separate report, the Bain Luxury Goods Worldwide Market Study Spring 2019, calls "a new Chinese luxury consumer". A large part of adapting successfully, in this context, has meant adapting digitally.

"China continues to dominate the global market," Bain says, "as local consumers demonstrate a strong preference for purchasing luxury goods at home thanks to price harmonisation, consumer-centred strategies, and governmental initiatives. Solid consumer confidence and willingness to buy, especially among young generations, are expected to [continue to] drive year-on-year growth of 18% to 20% in the region."

In its report, Gartner uses data-driven analysis to assess the "digital IQ" (DIQ) of luxury brands and to compare how each is faring against competitors. Key factors are a brand's use of its own websites, external e-commerce sites, digital marketing, social media and online sales using mobile devices. The research firm does this for other sectors and other markets, too, and uses a DIQ score of 100 as the halfway line, before placing each company in one of five categories: genius (DIQ of 140 or above), gifted (110-139), average (90-109), challenged (70-89) and feeble (below 70).

In China, this analysis has to focus on the way digital life functions there. The key search engine is Baidu, just as the key social media tools are Weibo and WeChat. More than half of global luxury brands are already operating their own WeChat stores. Engaging celebrities to offer social media endorsement of brands and products has to happen on Weibo and external e-commerce sites that give a good indication of a brand's popularity among luxury consumers in China include Tmall and JD.com.



Seeking luxury: a queue of consumers at a Louis Vuitton store in Nanjing. CREDIT: SHUTTERSTOCK

Cultural differences

One of the ways in which Gartner demonstrates the importance of this China-specific digital activity is to examine the negative effect of the famous and public online fall from grace of one prominent brand, Dolce & Gabbana. Late last year, Dolce & Gabbana wounded Chinese sensitivities by depicting consumers from there trying to eat pizza with chopsticks. Co-founder, Stefano Gabbana, was then alleged to have made negative comments about China on social media platform Instagram (he has claimed his account was hacked), which made matters much worse. Mr Gabbana and co-founder Domenico Dolce decided to make a video to apologise.

In it, Mr Dolce said: "We have been deeply in love with China and have visited many of its cities. We love its culture. That's why we are sorry if we made mistakes in the way we have interpreted it." For his part, Mr Gabbana said in the video: "We won't forget this experience and it will never happen again. We will do better in future and we will respect Chinese culture in every way possible."

According to Gartner, this attempted rapprochement did little to help the brand's plight. Between January and April this year, engagement on Weibo with Dolce & Gabbana was down by 95% compared to the same months in 2018. No Chinese celebrity would appear on the platform endorsing the Italian brand; its products were absent from major Chinese e-commerce platforms. Still an important company, Dolce & Gabbana ranked 38th out of 86 on Gartner's *Luxury China 2019* list, which includes watch, jewellery and fashion as well as leathergoods and footwear brands. Dolce & Gabbana came into the average category with a DIQ of 98, but five years ago it was frequently mentioned as one of the most popular international luxury brands in China.

Who's at the top now? Gartner categorises three brands as geniuses: Louis Vuitton, Bulgari and Cartier, with DIQs of 145, 144 and 141 respectively. The next 12 brands on the list are in the gifted category and include Gucci, clear in fourth with a DIQ of 134, followed by Mont Blanc, Coach, Burberry, Valentino, Bottega Veneta, Fendi and Prada. The last two of these shared 13th place,



achieving a DIQ of 111, 34 points behind Louis Vuitton.

Surprises among the brands sharing the average category with Dolce & Gabbana include Hermès, Bally, Tod's, Chanel and Loewe. For their part, Chloé, Salvatore Ferragamo and Furla find themselves among the challenged, while Christian Louboutin and Céline are classed by Gartner as feeble, with DIQs of 64 and 62 respectively. Watch brand Patek Philippe Genève comes last in this list, with a DIQ of 45.

The shape of shoes

In footwear, market estimates are that the global industry produced 24.2 billion pairs in 2018. Around 21.8 billion pairs were manufactured in Asia. China was still by far the biggest producer, although it lost some of its market share to Vietnam, India and Indonesia. As well as being the biggest manufacturer of shoes (of all kinds), China is the biggest consumer, with domestic sales of more than 4.4 billion pairs last year. In terms of export values, estimates are that global footwear exports last year had a value of more than \$140 billion and that China earned more than \$95 billion of this.

One major manufacturing group, Stella International, has been open about its plans for moving some of its manufacturing out of China. It opened a new factory in Hanoi, the capital of Vietnam, in 2017 and has spent time training up the workforce there to achieve the quality of finished product it wants. Increasing the volume of shoes it makes there will help it reach a stated ambition to manufacture 50% of its shoes in China and 50% in other Asian countries by the end of this year. In 2018, the group made 60.2 million pairs of shoes and achieved sales revenues of more than \$1.5 billion. These figures showed increases in volume and value of 6.4% and 2.7% respectively. Stella continued this positive momentum into this year, achieving production figures of 29.5 million pairs and revenues of around \$745 million, increases compared to the first half of last year of 1.7% and 2.9% respectively.

Ongoing talks, ongoing headaches

In a conversation with the US Hide, Skins and Leather Association (USHSLA) in July, *World Leather* learned that exporters of raw material to Chinese tanners are relieved to have come through the trade dispute relatively unscathed so far, but are worried that their products may become another target, another tree to shake as the tit-for-tat trade dispute continues.

Relatively unscathed means that, for almost all of the one year and eight months of mounting tension, the tariff Chinese importers have had to pay to bring US hides into the country has stayed constant at 8%. In this May's escalations, this went up to 13%. Lower hide prices have compensated for this in part (because the average price of wet blue has gone up) and Chinese tanners have continued to buy, but the volumes and values are down.

In the first five months of this year, Chinese buyers purchased a little under 4.4 million fresh hides from the US, paying \$180.3 million for them, an average of \$40.80 per piece. They also bought 486,506 wet blue hides from US traders over the January-May period at a cost of \$50.5 million, which equates to \$103.90 on average. Compared to the same months in 2018, fresh hide sales went down by 15% in volume and by 38% in value. The corresponding figures for wet blue are falls of 23% and 19%



Interior of one of Xingye's tanneries in south-eastern China. Chinese tanners have continued to source fresh hides and wet blue from the US, but the volumes and values are down. CREDIT: XINGYE LEATHER



The Ecco footwear factory in Xiamen. CREDIT: ECCO

respectively. In the first five months of 2018, the average price of fresh hides shipped from the US to China was \$55.62, while the average price of wet blue was \$98.18.

For hide traders, it is the uncertainty over what will happen next that is the big headache. It takes time for a cow, calf or bull to be ready for slaughter. It takes time for the hide that results from that slaughter to traverse the ocean and make its way to China for a tanner there to turn it into leather. For US packers and traders not to know what will happen next is the most frustrating aspect of the trade dispute.

USHSLA president, Stephen Sothmann, says there have been a number of times already since the start of 2018 when traders in the US felt they were under intense pressure to prepare hides for shipment to China at break-neck speed because they were sure increased tariffs were just around the corner. Even if, in the end, tariff hikes affecting their products directly did not materialise on those occasions, the uncertainty has caused great unease in the US hide sector. ☹